TIMBER BONDS AS INVESTMENTS

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The careful investor considers three things in choosing his investments: Security, income and marketability; usually in the order named. If, then, these are the features which interest him most, we should consider timber bonds from these points of view and in the above sequence, so that we may arrive at a fair conclusion as to their merits and right to be looked on as really high class securities.

In considering the first requisite, security, we must look into the value of the property mortgaged above the total loan, that is, its reasonably quick value; whether it is destructible and what the depreciation of the property is through lapse of time.

As to the loan value, the average investor, unless he be a lumberman, must, like most investors in all kinds of securities, depend largely upon his banking house for protection and assurance that the loan is a conservative percentage only of the real value of the property. Therefore, it is advisable to purchase such securities from a house of known conservatism and one that knows timber and its value through experience, for there are fairly good timber bonds and excellent timber bonds, just as there are fairly good railroad bonds and excellent railroad bonds, good commercial paper and excellent commercial paper.

Generally the percentage loaned on timber to its real value is remarkably small as compared with other loans. It is not infrequent for a loan to be secured by property having a value of three to four times the amount of the loan. It is seldom that a careful banker loans more than one-half of the value. In probably no other well known class of bonds is this true.

As to destructibility of the security back of the bonds, it is this feature and the public's partial misunderstandings in regard to it that most hurts timber bonds and has hindered them from occupying the position they deserve as high class securities. The general impression used to be that all timber was subject to devastating

fires and, therefore, it could not be considered except as highly speculative. This was largely brought about by the scare-heads we sometimes see in the papers, relative to forest fires. When one considers that many of the great fortunes of America are invested in timber by people who are not accustomed to take large risks, the conviction is brought home that the danger to timber from fire is outrageously exaggerated. As a matter of fact, timber is never destroyed by fire, and by destroyed we mean actually burned up. Indeed, a large part of the timber of America is absolutely immune from fire. Cypress, the wonderful southern wood growing in swamps and wet places with no low limbs, has never, so far as the writer knows, been attacked by fire. Yellow pine, growing over a large part of the South, fears no fires. The grasses growing beneath the pines usually burn every winter without damage to the trees. Fires are not known in the low hardwood country nor in the redwood belt in the West, and so one might go through the whole list of woods naming those which are free from the fire risk; but to reach our point let us consider some that have been subject to forest fires and see what these fires actually do.

From time to time we read that a forest fire has devastated the northern hardwoods of Michigan and Wisconsin or the fir and the pine of the great western country. When such a fire runs through these forests, trees are not burned down, but what occurs is that the grasses and undergrowth and fallen dead logs and dead trees are actually burned up. This intense heat shrivels the leaves of the surrounding trees and, since they are its lungs, it really kills the trees. Most of us know how nearly impossible it is to burn a green log in our fire places. Just so it is equally difficult, nay, even impossible, to burn down a green living tree; but these fires actually kill the trees without question and what results is simply this: disintegration slowly takes place, beginning the next summer. The sap wood of the tree, which, of course, contains the great mass of the tree's moisture, begins to discolor and becomes largely useless for good lumber; then, as time goes on, slowly the heart becomes damaged. This process covers a considerable period and where transportation is available it is usually possible to save practically the entire product. In the West disintegration is particularly slow, principally because of the large size of the trees and the much greater proportion of the heart wood to the sap wood. In addition, insects which hasten the

process of decay are not so common as they are in the middle, northern and southern states, so that the fire danger should not be given too great weight unless the timber securing the loan is remote from transportation and in a rough country where the creation of transportation facilities is extremely expensive, difficult and slow.

Lastly, under the head of security we should consider the natural depreciation of the security and it is here that timber loans have so great an advantage. The security back of the great mass of bonds is property of one form or another, created by the hands of men; behind the railroad bond is the right-of-way, the rail, the ties, the bridges, the culverts, etc., all subject to constant wear and tear, and necessarily replaced from time to time, and so we see good railroad bonds decline when the maker of the bonds is hard pressed for ready money and the maintenance fund is cut down and curtailed. The same is true of the electric railway bonds. Bonds issued by gas, electric light and telephone companies are secured, in addition to their franchises, by the plants, the buildings, the poles or conduits, the wires or pipes, all subject to constant depreciation, varying only with the class of construction that has been put in originally. The equipment obligations of the transportation companies are secured by movable property, absolutely necessary for the company's operations, but, nevertheless, subject to very heavy depreciation. Again, we have bonds secured by lots in our great cities, improved with large buildings or sometimes on the buildings alone. While the depreciation in this class is small, still it is always present in the case of the buildings, not alone from the natural cause of wear, but again because buildings rapidly become obsolete and out of date and as such cannot be rented. And so one might go through the great mass of properties back of most of the bond issues which are generally recognized as sound.

But what of the timber bond? It is secured by land upon which grows, without cultivation and without the help of man, timber. The amount in this country is pretty definitely known and there is both a steady and enormous demand for it at home and abroad. This limited supply, decreased year by year through the consumptive requirements, is, therefore, a natural monopoly. Its future value must depend upon the cost of substitutes and the cost of reproduction. We are to-day in the age of steel and concrete, two substitutes of large potentiality, yet the production and consumption of timber

products is at present on as large a scale as it has ever been. The cost of reproduction has been closely estimated and it is so far in excess of present values as to make it impossible of our consideration. We, therefore, have a product, limited in extent, and for which there is an increasing demand. Its value is now low and it must rise, judged by every economic law we know. This is so generally recognized that it is often remarked about a mediocre timber bond issue that it will come out all right through the enhancement in values.

While lumbering plants are usually included in timber bond mortgages, where the loan is to an operating concern, little value is given to the plants in considering the loan, and in practically all cases the plant is a very small part of the security offered. Beneath all the timber is the land, possibly of small value when the loan is made and probably not considered at all by the banking house in making the loan, and yet it is a basic security. There have been many lumber companies that have sold their land after the timber was removed for more than both the land and timber cost them in the first place; and so we have in the timber bond a security which, under economic laws, must increase in value and which has, during the history of the lumber business in America, steadily risen. Many are the lumber concerns which have been badly managed and which would have regularly lost money in their manufacturing operations if in their accounting they had considered the actual value of the raw product they were using. But the owners of these concerns, through the rise in value of their timber, have made fortunes and been known as successful manufacturers.

Next in the order of importance is considered the income. Most timber bonds bear six per cent interest, payable semi-annually, and often when issues are first brought out the investor can secure a small additional discount of a quarter to a half point, especially if he is a large buyer. Compared to this income is the four per cent to five per cent of the railroad bond or the five per cent to five and a half per cent for the average public service or industrial bond, an advantage of from one-half of one per cent to two per cent in favor of the timber bond. As previously indicated, there are timber bonds secured by timber together with mills, railroad and equipment necessary for the manufacture of lumber, and there are also timber bonds secured by timber alone without a manufacturing plant. In the first case the plant is calculated to have sufficient capacity to amply take care

of all interest charges. In the second case the bonds are usually guaranteed by individuals or corporations having sufficient outside income to easily care for the principal and interest installments as they fall due. In either case if the security back of the bonds is ample and the loan is far below the actual quick selling value of the timber the investor is fully protected.

Last, and yet of great importance, is the question of convertibility or marketability. Can the timber bond be readily sold in time of need? It is seldom, if ever, listed on the public exchanges. There is no daily printed market of the bid and asked. Generally it might be termed an inactive security. It is these very reasons which enable the first class timber bond house to make for their issues a good steady market. For timber bonds are bought for investment and the interest return and being held by investors and producing so satisfactory an income they are seldom sold again, even in times of stress. Not being listed, the holder is not continually annoyed by printed declines, or lower prices, brought about by sympathy with a falling market. In consequence, the first class timber bond, once well sold, is seldom thrown on the market. These conditions enable the banking house who brought the issue out to properly protect and steady the market for their securities. In addition, such houses know that a ready market for their bonds is most desirable and the best method of advertising. There is, too, the moral relation between the banking house and its client, which is always lost when one is dealing in listed securities through brokers who have had nothing to do with the underwriting or marketing of a particular issue of bonds. A banking house of high standing, therefore, seldom permits its issues to be offered at much below the original public issue price, and generally even in times of storm such banking houses are ready to purchase back bonds it has brought out, usually at one or at most two points under par. The possible loss under such conditions should be figured from an income basis, for if the investor has held his bond for any reasonable length of time he has secured a very fair interest return. On the other hand, in ordinary times the excellent issues handled by the best houses usually have a market at par or oftentimes at decided premiums.

After all, if timber bonds are in reality so secure, such high income bearing investments and are readily convertible, why do they sell on a six per cent basis, when other recognized high class bonds net

so much less? The answer is that the investing public has not been fully educated to the merits of timber bonds. They are now being educated, and slowly, but surely, the discriminating public is coming to realize the intrinsic merit of timber bonds. The demand for them is growing larger, particularly for the really excellent issues, and so intense is the competition between banking houses to secure these high class bonds that the combined pressure of limited supply and increasing demand can only result in one thing, the end of the first class six per cent timber bond. With money market conditions such as are now prevailing there can be but one result, timber bonds on a lower interest basis. The writer feels that such a time is very near and that it only remains for a banking house of unquestioned standing to take the first step. Indeed, there are six per cent issues outstanding to-day that are actually selling on a five per cent basis, and it is firmly believed that such excellent issues will soon be brought out and offered to the public to net considerably less than six per cent. The best buyers of timber bonds now are lumbermen who have become investors, and surely no higher recommendation could be found.